

**STAFF REPORT ON TRACK B:  
COMPETITIVE SOLICITATION  
DOCKET NOS E-00000A-02-0051 ET AL.**

**OCTOBER 25, 2002**

# STAFF REPORT

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# STAFF REPORT

## 1. Introduction

Staff's goal is to have a transparent process that results in cost savings for ratepayers. The major benefit of a utility obtaining power through competitive solicitation is cost savings for ratepayers. Competition can help to obtain the best deal for ratepayers. However, a solicitation process needs to be designed in such a way as to ensure that benefits occur instead of pitfalls. In order to facilitate a manageable transition to a competitive wholesale power market that provides economic benefits to consumers in Arizona, the Staff believes that a transparent process, one that is equitable and auditable, needs to be established. That process must be well developed, flexible, and understood by all participants in the process. Furthermore, the process must result in reliable power being available over the long term at prices that are reasonable. Finally, all bidders prepared to provide power must be afforded the opportunity to compete for sales on equal and unbiased terms. The following pages describe a set of steps and requirements that, if adopted, will establish a process that encourages development of a wholesale market that benefits consumers.

The process described herein is intended to be used by Arizona utilities, as applicable, in the initial solicitation for competitive power to be commenced by March 2003. Subsequent solicitations may be conducted using this process. More likely, changes to the process will be recommended based on lessons learned from the initial solicitation and changes in wholesale market conditions as well as consideration of non-price factors.

## 2. Overview of Track B Proceeding

### A. Background

On October 18, 2001, Arizona Public Service Company ("APS") filed a request for a variance to A.A.C. R-14-2-1606(B) and Approval of a Purchase Power Agreement (Docket No.

1 E-01345A-01-0822). On January 22, 2002, by Procedural Order, a generic docket (Docket No. E-  
2 00000A-02-0051) was opened to examine various electric restructuring issues. The  
3 Commissioners, through a series of letters requested that the parties file responses to questions  
4 regarding certain aspects of electric competition in the generic electric restructuring docket. On  
5 January 28, 2002, Tucson Electric Power Company (“TEP”) filed a request for a variance to  
6 A.A.C. R-14-2-1606(B). On April 25, 2002, the Arizona Corporation Commission  
7 (“Commission”) held a Special Open Meeting, at which the Commission stayed APS’ Request for  
8 a Variance, and directed that certain issues be addressed in the generic electric restructuring  
9 docket. The Commission divided the issues to be addressed into two tracks, A and B. The Track  
10 A issues identified are the transfer of assets and associated market power issues, code of conduct  
11 issues, the Affiliated Interest rules, and jurisdictional issues. The Track B issue identified is the  
12 development of a competitive solicitation process.

13 On September 10, 2002, in Decision No. 65154 the Commission issued its decision in the  
14 Track A proceeding. In the Track A decision, the Commission stayed A.A.C. R-14-2-1606(B)  
15 which required that 100 percent of power purchased for Standard Offer Service shall be acquired  
16 from the competitive market, with at least 50 percent through competitive bid. However, the  
17 decision directed APS and TEP to acquire, at a minimum, any required power that cannot be  
18 produced from its own existing assets, through the competitive procurement process as developed  
19 in the Track B proceeding. The Decision further ordered that the amount of power, timing, and  
20 the form of procurement be determined in the Track B proceeding with the target date for a  
21 competitive solicitation process taking place by March 1, 2002.

## 22 **B. Participants**

23 The parties that have participated in one or all of the Track B workshops are: APS, TEP,  
24 Pinnacle West Capital Corporation, Panda Gila River, L.P., Reliant Resources, Inc., PG&E  
25 National Energy Group, Harquahala Generating Company, Sempra Energy Resources, Wellton  
26 Mohawk Generating Facility, Duke Energy North America, LLC, Calpine Corporation,  
27 Southwestern Power Group II, PPL Southwest Generation Holdings, LLC, PPL EnergyPlus, LLC,  
28 PPL Sundance Energy LLC, El Paso Electric, Desert Energy, Public Service Company of New

1 Mexico, Citizens Utilities Company, Salt River Project, the Grand Canyon State Electric  
2 Cooperative, Association, Inc., the Arizona Independent Scheduling Administrator Association,  
3 the Arizona Competitive Power Alliance, the Arizona Utilities Investors Association, Arizonans  
4 for Electric Choice in Competition, Arizona Transmission Dependent Utility Group, Arizona  
5 Clean Energy Industries Alliance, the Land and Water Fund of the Rockies, the Residential  
6 Utilities Consumer Office, NERA Economic Consulting, R.W. Beck, Inc., Industrial Power  
7 Technology, the City of Scottsdale, the City of Tucson, and Staff.

### 8 **C. Collaborative Process**

9 The workshops were conducted on July 24 and 25, 2002, August 13 and 14, 2002, and  
10 September 26 and 27, 2002. Prior to each workshop, an agenda was sent electronically to the  
11 distribution list and posted to the Utilities Division website. Staff developed a draft working  
12 paper regarding the competitive solicitation process and parties were able to provide substantive  
13 comment and make suggestions to Staff on the draft-solicitation process. A variety of issues  
14 relating to competitive bidding were raised, and through the collaborative process, the parties  
15 reached agreements in principal on several areas which are listed on page 34 of this report.  
16

## 17 **3. The Solicitation Process**

### 18 **A. Specific Process Goals**

19

20 As more fully detailed in the following sections of this chapter, the Staff's goal in  
21 proposing this process is to facilitate a manageable transition to a competitive wholesale power  
22 market that provides economic benefits to consumers in Arizona. The proposed process has been  
23 designed to be open to all bidders, flexible, understandable by all participants in the process, and  
24 to result in reliable power being available over the long term at prices that are reasonable.

25 The process was developed with the view that prevailing wholesale market conditions are  
26 dynamic and that the potentially favorable conditions for buyers today are subject to potentially

1 significant changes over time. Accordingly, the Staff has developed a process that aligns the  
2 utilities' responsibilities for providing reliable service at reasonable rates with the authority to  
3 manage their power supply portfolios in a prudent manner. The process also preserves all of the  
4 Commission's ability to regulate the actions of its jurisdictional companies in a way that best  
5 serves the public interest.

6 The process described below is intended to be used by Arizona utilities, as applicable, in  
7 the initial solicitation for competitive power to be commenced by March 2003. If adopted, the  
8 Track A requirement of beginning a competitive solicitation by March 2003 will be met.  
9 Subsequent solicitations may be conducted using this process. More likely, changes to the  
10 process will be recommended based on lessons learned from the initial solicitation and to reflect  
11 changes in wholesale market conditions as well as to take into consideration non-price factors that  
12 have not been incorporated into the process at this time.

#### 13 **B. Assumptions Supporting the Proposed Process**

14  
15 Basic assumptions were developed by the Staff in preparing this proposed Solicitation  
16 Process, including the assumption that the process itself had to be flexible enough to allow  
17 purchasing utilities and selling merchants the latitude to structure the terms and conditions under  
18 which service would be provided in a manner that made economic, operational and regulatory  
19 sense, and provided benefits to all affected parties. Accordingly, the Staff has assumed that this  
20 process, if adopted, will be subject to changes based on the lessons learned during the initial  
21 solicitation conducted by the utilities during 2003. To the extent that a utility has load  
22 requirements, capacity or energy, not served by generating capacity owned by the utility or  
23 through existing contracts for capacity or energy or from sources from which the utility must  
24 purchase power as a result of law or regulation, that unmet need will be acquired through a  
25 competitive solicitation. Short-term power and daily, weekly or monthly power acquired to meet  
26 unplanned needs, would however continue to be purchased in the normal course of business as it  
27 is today.

1       The Staff assumed that all current regulatory standards would be maintained and that post  
2 solicitation reviews of the manner in which the solicitations were conducted and the  
3 appropriateness of the power supplies purchased would be reviewed by the Commission at  
4 hearings to be scheduled by the Commission at such time as it deems proper.

5       In conducting the initial solicitation, the Staff assumed that an independent party would  
6 monitor the process to provide assurances to all parties that the process was implemented as  
7 proposed and that no bidder was afforded an undue advantage or disadvantage.

8       Finally, the Staff assumed that no RTO or ISO would be operational prior to July 2003  
9 and that each utility would make available to all bidders transmission access on its system in an  
10 unbiased fashion and that each utility would cooperate with all bidders in planning and scheduling  
11 deliveries of power.

### 12       **C. Alternative Approaches Considered**

13  
14       In developing the proposed solicitation process detailed in the following section of this  
15 report, the Staff examined numerous alternative approaches to structuring the process. Among  
16 those were proposals relating to the amount of power to be procured, restrictions on the ability of  
17 the utility or any of its affiliated companies to participate in any solicitation, the type of  
18 procurement mechanisms (e.g. auctions, RFP's, bilateral contract negotiations) to be employed  
19 and the various roles and responsibilities to be assumed by the utility, the bidders, the Staff, the  
20 Commission and other persons participating in the solicitation process. Additionally, the Staff  
21 reviewed a myriad of potential terms and conditions that could be incorporated in any solicitation.

22       Many of those alternatives and potential terms and conditions were presented to the  
23 participants in the Track B workshops for their comments and input. The testing of the alternative  
24 approaches considered by the Staff and the terms and conditions reviewed has resulted in a  
25 significant narrowing of the issues that initially existed between the parties to Track B and has in  
26 the opinion of the Staff significantly contributed to the quality of the proposed process. In the  
27 following section of this Report the Staff presents the detailed proposed Solicitation Process it  
28 believes will best serve to meet the goals it set out above.

## **D. Detailed Staff Proposed Solicitation Process**

### **I. Scope Of 2003 Solicitation**

For 2003, the solicitation will be for all load and energy requirements not served by generation owned by the utility and included in the utility's rate base as of September 1, 2002, except to the extent that such generation is providing RMR service during RMR hours or by power supplied pursuant to FERC or Commission approved contracts with affiliated and non-affiliated suppliers entered into prior to September 1, 2002. To the extent that affiliated suppliers provide service pursuant to contracts dated on or after September 1, 2002, such service will be subject to competitive solicitation except to the extent that such contract is to provide RMR service during RMR hours. To the extent that load is served pursuant to capacity or energy contracts with Qualifying Facilities or Environmental Portfolio Standard requirements, that load will also not be contestable. Any generation capacity owned by a utility that has not been included in the utility's rate base may be bid by the utility in the initial solicitation on the same terms and conditions as all other bidders, including affiliated bidders. All demand-side management commitments in place as of September 1, 2002, shall be considered in determining contestable load.

For solicitations during 2003, each utility may contract for energy and capacity deliveries for differing time periods in order to test the efficiency of this process for acquiring short-term, medium-term and long-term contracts. While it is anticipated that during 2003 each utility will primarily require peaking capacity and energy with contract terms of one to three years, if, in the judgment of the utility, market conditions or economic opportunities dictate contract terms longer than three years, it will be the responsibility of the utility to enter into such contracts as are reasonable. For resource planning purposes each utility must demonstrate that its power supply portfolio contract durations are adequately diversified and that its portfolio's structure mitigates both cost and reliability risks appropriately.



Based on information available at this time, contestable loads for each utility for each year through 2006 are estimated to be:

CAPACITY (MW)

	2003	2004	2005	2006
APS <sup>1</sup>	1951	2289	2628	2898
TEP <sup>2</sup>	242	309	441	488

ENERGY (MWH)

	2003	2004	2005	2006
APS <sup>3</sup>	6,566,910	7,704,591	8,845,638	9,754,436
TEP <sup>4</sup>	345,300	345,460	388,460	389,460

The above capacity numbers for APS were provided by APS at the August workshop and were used by Staff to derive the energy numbers. Staff was subsequently informed by APS that the numbers provided at the August workshop required revision. In response to a data request from Staff, APS provided revised capacity and energy numbers on October 23, 2002. Staff has not had time to review and analyze these numbers for inclusion in the Staff report by the October 25, 2002 publication date. APS' response to Staff's data request is included in this report as Appendix Two.

## **II. Roles & Responsibilities**

### **A. Utility**

<sup>1</sup> Source: From data provided by APS at the August Workshop.

<sup>2</sup> Source: From data provided by TEP at the August Workshop, plus 95 MW of combustion turbines that are not presently in rate base.

<sup>3</sup> Assumes 38.6% average annual load factor for all contestable capacity.

<sup>4</sup> From August data provided by TEP plus 95 MW combustion turbines at 40% average annual load factor.

1 Absent evidence of abuse, the utility will be responsible for preparing the solicitation and  
2 conducting the solicitation process. Acquisition of energy and capacity to meet the needs of  
3 customers remains the responsibility of the utility, and the utility shall use accepted business  
4 standards for acquiring these resources, as it does when it buys all other products used in  
5 providing service.

## 6 **B. Bidders**

7  
8 In order for the Solicitation to attract wide participation, the process must be accepted as  
9 fair, open and transparent. To achieve this, prospective bidders, and interested persons who agree  
10 to keep certain information confidential, will have the opportunity to review supporting data and  
11 draft documents in advance of the solicitation being distributed to bidders. All bidders and other  
12 interested persons may provide comments to the utility, the Independent Monitor or the Staff  
13 regarding the completeness or quality of the information provided. Bidders and interested parties  
14 may also provide comments to the utility, the Independent Monitor or the Staff regarding the  
15 process being employed or the decisions made regarding execution of the solicitation process.

16 All bidders will be required to consent to use appropriate alternative dispute resolution  
17 practices, specified by the utility and fully disclosed in the Solicitation materials if a dispute  
18 arises.

19 Each bidder must agree to permit the Commission Staff to inspect any generating facility  
20 the bidder owns or controls from which it proposes to provide capacity or energy to any Arizona  
21 utility pursuant to any contract awarded as a result of this solicitation.

### 22 **1. Access to data**

23  
24 Bidders will have the opportunity to review non-restricted information used by the utility  
25 in preparation for the solicitation, as well as draft solicitation materials, before the solicitation is  
26 released. Bidders may provide comments to the Staff and the Independent Monitor regarding the  
27 materials at any time before the bidders' conference.

## **2. Opportunities to contribute & review**

One or more bidders' conferences will be held so that all interested parties will have the opportunity to ask questions directly of the utility as well as to identify any deficiencies in the solicitation documents or supporting data. The bidders' conference will be held at least 10 days before the release of the solicitation.

Each utility shall schedule at least one bidders' conference prior to the distribution of its solicitation materials in final form to answer questions and to receive comments and suggestions regarding the materials to be distributed from interested persons. The first bidders' conference must occur no later than February 15, 2003.

Bidders will be invited to review non-proprietary materials produced by the utility and to address comments or inquiries to the utility, Staff or the Independent Monitor regarding those materials at any time between the release of reports, plans or drafts and the conclusion of the bidders' conference.

### **C. Independent Monitor**

#### **1. Overview**

To assist the Staff and to assure all parties to the Solicitation for power supplies that the process employed is conducted in a transparent, effective, efficient and equitable manner, an Independent Monitor will be appointed by the Staff of the Commission to oversee the conduct of the Solicitation. The Independent Monitor will be selected by the Staff and will work at the Staff's direction. Any person expecting to participate in the solicitation process may suggest to the Staff any individual to serve as the Independent Monitor. The utility will retain the Independent Monitor selected by the Staff and will be responsible for all related costs. The Independent Monitor shall submit all invoices to the Staff for review. The Staff shall forward the invoices to the utility with a recommendation as to payment.

1 The Independent Monitor will be responsible for:

- 2 • monitoring all communications regarding the solicitation by and among the utility
- 3 and any bidders or potential bidders;
- 4 • evaluating the adequacy, accuracy and completeness of all solicitation materials,
- 5 and the quality of the evaluations conducted;
- 6 • monitoring any negotiations conducted by the utility and any bidder;
- 7 • assisting the Staff in developing the “prices to beat” and such other tasks as
- 8 required;
- 9 • advising the Staff and the utility of any issue affecting the integrity of the
- 10 solicitation process and providing the utility an opportunity to remedy the defect
- 11 identified;
- 12 • periodically submitting status reports to the Commission and the Staff on the
- 13 solicitation being conducted, noting any deficiencies identified in the preparation
- 14 of solicitation materials, maintenance of records, communications with bidders, or
- 15 in evaluating or selecting bids;
- 16 • advising the Commission and the Staff of significant unresolved issues as they
- 17 arise;
- 18 • after bids have been selected, preparing and submitting a report to the Commission
- 19 detailing the Independent Monitor’s observations and findings relating to the
- 20 conduct of the solicitation and any recommendations for improvements of the
- 21 solicitation process employed in the initial solicitation; and
- 22 • making all written status reports and the final reports to the Commission available
- 23 to any person having an interest in the solicitation.

24 The Independent Monitor shall have full access to all materials used in or relating to the  
25 Solicitation. The utility shall make its personnel available for consultation with the Independent  
26 Monitor as requested. The Independent Monitor shall attend, in person or telephonically, any  
27 negotiations conducted with bidders.

Following the bidders conferences and before the distribution of the solicitation materials, the Independent Monitor shall submit a status report to the Commission and the Staff noting any unresolved issues that could impair the equity or appropriateness of the solicitation process.

## **2. Post Selection Requirements**

Subsequent to the final bid selections and prior to announcing the selection of winning bids, the utility shall meet with the Staff and the Independent Monitor to review its bid evaluations and to explain the basis for its selections. Within 3 days of the selection of winning bids, the Independent Monitor will file with the Commission a status report identifying the winning bids and outlining any deficiencies noted in the solicitation process.

The Independent Monitor will also file with the Commission a report on the fairness and effectiveness of the solicitation within 14 days of the selection of winning bids. In that report, the Independent Monitor will describe the process employed and will evaluate the utilities' conformity with the process requirements. If the Independent Monitor finds that the utility unfairly or erroneously conducted the solicitation, the report should so state. If the Independent Monitor believes that the selection process was flawed, the report submitted should detail the Independent Monitor's basis for such belief.

## **D. Staff**

Throughout the solicitation process, the Staff and Independent Monitor will review data, review draft solicitation materials, and monitor the solicitation process. The Staff will observe the solicitation process, but will not approve any action or certify any aspect of the solicitation activities. If any disagreement concerning the solicitation occurs, the Staff or the Independent Monitor will promptly notify the utility of its concern and discuss the matter with the utility.

The Staff, in conjunction with the Independent Monitor, will be responsible for reviewing the resource plans, the price and cost forecasts, and the network transmission assessment to encourage the utility to develop comprehensive supporting data, and advise the Commission should the utility fail to address the information needs of the solicitation process. Also, the Staff

1 and the Independent Monitor will review forecast data provided by interested parties and compare  
2 it to the forecasts provided by the utility when assessing the system needs.

### 3 **E. Commission**

4  
5 The Commission may upon request of the Independent Monitor or at such time or times as  
6 it deems appropriate, suspend or terminate the Solicitation in order to remedy any defect in the  
7 solicitation process identified by the Independent Monitor. The Commission may order the utility  
8 conducting the Solicitation to make changes to the solicitation process it deems necessary to  
9 promote effectiveness, reasonableness, and fairness.

10 In the event that the Independent Monitor finds that the utility failed to conduct the  
11 solicitation in an equitable manner, the Commission, after notice and hearing, may, among other  
12 things, disallow the recovery of costs of power incurred pursuant to contracts entered as a result  
13 of this Solicitation as well as the costs of conducting the solicitation or bar any bidder inequitably  
14 awarded a contract as a result of the solicitation from bidding in any subsequent solicitation. If  
15 the Commission finds that the utility failed to conduct an appropriate solicitation, it may order  
16 that a new solicitation, conducted by an independent party, be commenced forthwith.

## 17 **III. Pre-Solicitation**

### 18 19 **A. Overview of process**

20  
21 In order to be ready to conduct a solicitation by March 1, 2003, as required by the Track A  
22 order, the utility must assemble information supporting the determination of products to be  
23 solicited and the amount of each product that is needed. The utility must be prepared to evaluate,  
24 without delay, all offers presented, including offers to deliver power to points that may differ  
25 from the utility's requested points of interconnection. The required data typically collected in the  
26 ordinary course of business will serve as the basis for all information to be provided to the Staff,  
27 Independent Monitor and bidders, though some will need to be modified to be suitable for the

solicitation. To facilitate a timely solicitation, the utility should begin assembling the necessary information without delay.

## **B. Data Collection**

Prior to preparation of solicitation materials, supporting data shall be assembled by the utility and provided to the Staff and the Independent Monitor for their review at the earliest date practicable. These data shall include resource plans, load, price, and cost forecasts, and a network transmission assessment containing such information and in formats acceptable to the Staff, designed to facilitate the solicitation process. Once the Staff and the Independent Monitor have completed their review, the following data shall be made available to bidders expressing intent to bid and who have signed a confidentiality agreement: load forecasts, resource plans, needs assessments, and transmission assessments, as appropriate. Price and cost forecasts for power supplies and fuel costs prepared by, or available to the utility, will not be made available to bidders. Bidders may provide comments to the Staff or Independent Monitor on the quality or completeness of any information provided at any time.

In preparation for the solicitation, each utility shall prepare a list of potential bidders to whom bid materials will be sent. That list should be as expansive as is reasonable. Once assembled, that list is to be provided to the Staff and the Independent Monitor and posted on the solicitation website. Identified potential bidders are to be contacted and invited to submit a letter of intent to bid. Prospective bidders not identified by the utility will be added to the bidders list by submitting a letter of intent to bid.

## **C. Resource Plans**

Prior to the first solicitation, each utility that will solicit power during 2003 must provide to the Staff and the Independent Monitor its current 10-year load and energy forecast and resource plan. Utility personnel must be made available to discuss the load forecast and resource plans with the Staff and the Independent Monitor.

1 The Resource Plan must describe all power sources currently employed to meet load  
2 including: generation owned by the utility, existing power supply contracts with affiliated and  
3 non-affiliated utilities, planned additions and retirements, contract expirations, loads to be met  
4 through the use of demand side management and contracts to satisfy the Environmental Portfolio  
5 Standard. The Resource Plan should identify RMR plants, the hours during which such plants are  
6 RMR, and the criteria employed to determine RMR. Additionally, the Resource Plan should  
7 detail the utility's planned outage schedule and any planned unavailability of power from contract  
8 suppliers. Planned reserve requirements shall also be specifically identified.

9 The utility will review with the Staff and the Independent Monitor the adequacy of  
10 resources committed to serve expected loads and the reliability of the resources planned to serve  
11 that load.

12 Based on the utility's load and energy forecast and the resource plan, the utility will  
13 develop a needs assessment. The needs assessment will be designed to identify specific capacity  
14 and energy needs and such other services and/or facilities as may be needed over the term of the  
15 load forecast.

16 The load forecast, resource plan and needs assessment will be reviewed with the Staff and  
17 the Independent Monitor.

#### 18 **D. Price & Cost Forecasts**

19

20 Each utility will provide to the Staff and the Independent Monitor its four-year forecast of  
21 its power supply costs from its existing power sources.

22 Each utility shall provide to the Staff and the Independent Monitor the forecast of fuel  
23 prices that the utility used in preparation of its power supply costs and all other fuel forecasts  
24 relied on, or reviewed by, the utility.

25 Additionally, each utility shall provide to the Staff and the Independent Monitor a four-  
26 year forecast of the prices of wholesale power products, including both capacity and energy  
27 products by season and time period, in Western wholesale markets for delivery in Arizona  
28 prepared by an independent source that makes such estimates available in the normal course of its



1 business. Each utility shall also provide to the Staff and the Independent Monitor copies of all  
2 other forecasts of the prices of wholesale power supplies in Western wholesale markets for  
3 delivery in Arizona in the possession of or reviewed by the utility. The utility shall identify the  
4 source of each such forecast, and explain the strengths and weaknesses of each of the forecasts  
5 supplied.

6 Potential bidders may also submit wholesale price forecasts to the Staff. Those forecasts  
7 must clearly identify the source of the forecast and all assumptions relied on in preparing the  
8 forecast.

9 All forecasts provided will remain confidential and will serve as the basis for certain  
10 evaluative and review purposes as are discussed later in this document. During the reviews  
11 described above, the Staff and the Independent Monitor will examine the assumptions relied on in  
12 making the forecasts and assessments presented.

#### 13 **E. Deliverability Qualifications**

14

15 The utility must provide Staff and the Independent Monitor with a listing of each  
16 committed use of its transmission capacity for the period over which resources are to be solicited.

17 The utility will perform and submit for review by the Staff and the Independent Monitor a  
18 network transmission assessment of the maximum resource capacity that can be physically and  
19 reliably accommodated simultaneously at all technologically feasible interconnection and delivery  
20 points. Such transmission limitations are to be used as a guide in the evaluation of deliverability  
21 of specific combinations of bid resource capacity and energy.

22 Upon completion of this review, the utility will be responsible for preparing and  
23 conducting a solicitation that encourages multiple bidders to respond to the solicitation. The  
24 specifics of products to be solicited, contract terms and conditions, terms of the confidentiality  
25 agreement, and the specific solicitation mechanics to be employed will be at the discretion of the  
26 utility. In any event, the process must be designed to promote acquisition of reliable power at  
27 reasonable costs over the long term.

1           **F.           Identification of Products**

2

3           Each utility shall determine the specific products it will contract for in order to maintain  
4 an appropriately structured power supply portfolio. For 2003, utilities may request bids for firm  
5 power (e.g. on-peak and off-peak, annual or seasonal, capacity and energy blocks), and unit  
6 contingent supplies, as appropriate. Additionally, to the extent required, solicitations for ancillary  
7 services including, but not limited to, load following or spinning reserves, may be undertaken. It  
8 is, anticipated that bidders will provide all ancillary services required to support their bids. If the  
9 utility provides ancillary services to any generating asset not in its rate base, the utility shall make  
10 those ancillary services available to all bidders on the same terms and at the same price as  
11 available to those assets.

12           In identifying the products to be contracted for, the utility will specifically define the  
13 capacity and energy sought on a time-differentiated basis and the periods for which services will  
14 be purchased. The solicitation materials will contain the terms and conditions proposed by the  
15 utility, including the right of the utility to reject all bids and to amend the request for service  
16 without notice. The solicitation materials shall include a model contract.

17           **IV. Preparation Of Initial Solicitation**

18

19           **A.           Overview**

20

21           The materials to be provided to potential bidders shall be prepared by the utility and shall  
22 be developed in a manner that facilitates the preparation of responsive and competitive bids. The  
23 materials must be accurate and sufficiently detailed so that no bidder is afforded an undue  
24 advantage. The terms and conditions must be reasonable and commercially acceptable and must  
25 be reviewed by the Independent Monitor and the Staff.

1           **B.           Solicitation Material Content**

2

3           The utility will have responsibility for preparing all solicitation materials. The materials  
4 will be prepared in a timely manner so that the Staff and the Independent Monitor will have time  
5 to review the documents and suggest changes, before they are provided to interested parties for  
6 comment.

7           The utility will prepare bid packages that contain a description of the specific products to  
8 be acquired, the capacity and energy to be acquired, the bidding method to be employed (e.g.  
9 Request for Proposal or Descending Clock Auction), a copy of the contract to be executed, the  
10 preferred delivery points, the evaluation criteria to be used, bid fees (if any), credit requirements,  
11 due dates and such other information as may be appropriate.

12           It will be the responsibility of the utility to prepare draft solicitation materials and to discuss  
13 these drafts with the Staff and the Independent Monitor prior to distributing them in draft form to  
14 potential bidders. These drafts will include but will not be limited to: the specific power supply  
15 products sought, points of delivery, a model contract and confidentiality agreement, the bid  
16 requirements, pre-qualification requirements, creditworthiness requirements, the solicitation  
17 method to be employed, information describing the utility and its forecast load, and the evaluation  
18 criteria to be used.

19           In the Solicitation materials the utility will describe in detail how it will conduct bidding,  
20 such as how many rounds of bids will be accepted, Descending Clock Auction procedures, etc.  
21 The utility may specify that bids must be firm and for how long bids must be open after the  
22 auction is completed. If a Request for Proposal is used, a utility may specify that bids must be  
23 valid for up to 30 days.

24           Price caps or auction reserve prices may be established by the utility. Any caps or auction  
25 reserve prices established must be disclosed to and discussed with the Staff and the Independent  
26 Monitor before the solicitation occurs. No limitations are to be placed on the maximum or  
27 minimum capacity or energy that any bidder may bid for or provide.

1 The solicitation materials will also describe the criteria to be used to select winning bids  
2 and the weighting, if any, to be placed on each criterion.

3 The following criteria may be used to evaluate bids:

- 4 - Delivered price
- 5 - Deliverability
- 6 - Reliability
- 7 - Creditworthiness
- 8 - The source(s) of power for unit contingent products
- 9 - System benefits
- 10 - Exceptions to bid specifications and/or model contract terms and  
11 conditions
- 12 - Other criteria as appropriate and made publicly available

13 The bid package prepared by the utility should specify preferred delivery points and, if  
14 available, equivalent delivery points and any incremental costs the utility will incur if bidders  
15 deliver to those equivalent delivery points. The utility shall disclose to the bidders the existence of  
16 the network transmission assessment previously provided to the Staff and the Independent  
17 Monitor, and disclose that the assessment will be used in evaluating equivalent delivery points.  
18 The solicitation materials will specify the process the utility will use to identify whether any  
19 constraints would be created on its system as a result of deliveries to any alternative delivery  
20 point, how it will estimate the cost and time required to relieve the constraint, and the costs a  
21 bidder will incur to mitigate the constraint.

22 The bid materials will also describe the Supplier information to be provided and the dates  
23 when such information is due. This requirement may include a demonstration of the bidder's  
24 experience in providing services and evidence of the bidder's creditworthiness. Utilities shall  
25 require bidders to provide a description of the sources of electricity they intend to use to supply  
26 service.

27 The bid materials will specifically describe the credit support acceptable to the utility both  
28 as to form and amount. However, bidders may provide alternative credit support arrangements

and, if equivalent to that specified, the utility must evaluate the proposal as it would a conforming bid. Equivalent credit support arrangements may include, but will not be limited to, appropriate parental or affiliate guarantees.

Bid materials will also include:

- A draft Confidentiality Agreement
- Identification of any pre-qualification requirements
- Identification of any bid fees

### **C. Communications**

Only those employees, officers, directors or contractors of the utility or its affiliates specifically assigned by January 1, 2003, to prepare the solicitation materials or to evaluate bids received, may participate in the preparation of solicitation materials or evaluation of bids. All persons assigned to the solicitation by the utility shall be subject to a standard of conduct established for the purpose of maintaining a separation between the utility and any affiliated entity or person. Persons who work for an affiliate, parent, or part of the utility involved in the sale or marketing of resources from generating assets owned by the utility shall not participate in the solicitation preparation or evaluation of bids, or have any contact regarding the solicitation with any personnel assigned to conduct the solicitation, except on the same terms as any other bidder.

A protocol shall be established for all communications between the utility and all prospective bidders, regardless of whether they are affiliates or third party bidders. The protocol must prohibit the dissemination of any data to an affiliated person that are not provided to all other interested persons on equal terms and at the same time. The utility will identify to the Staff and the Independent Monitor, the information it proposes to restrict access to by bidders and other interested persons.

The Staff and the Independent Monitor will review all draft solicitation materials before they are released to the parties for their review.

1 Concurrently, the utility will establish the procedures it will employ to communicate with  
2 all potential bidders. That communications plan must be designed to maintain confidentiality and  
3 to provide equal access to information to all. All bidders, including utility affiliates, must be  
4 required to communicate with the utility on equal terms. The approach adopted must be shown to  
5 provide no undue advantage to any potential bidder.

6 By January 1, 2003, each utility shall establish and maintain a solicitation website as the  
7 medium for communicating with bidders prior to the bid date, except for confidential exchanges  
8 regarding pre-qualification and creditworthiness. Bidders will address all inquiries to the utility  
9 on the website. Each inquiry and the utility response thereto shall be posted so that all bidders  
10 have equal access to information. The website will also be used to provide timely access to data  
11 and other information, such as the bidders list and the form letter of intent to bid that bidders may  
12 use to be placed on the bidders list.

13 Pre-solicitation data shall be posted on the website as soon as it has been reviewed by  
14 Staff and the Independent Monitor but in no case less than 5 days before the last bidders'  
15 conference.

16 Bidder inquiries to the Independent Monitor may also be addressed using the solicitation  
17 website. All bidder inquiries to the Independent Monitor and the response provided, regardless of  
18 how the inquiry is made, will be posted on the solicitation website for review by all bidders.

19 As part of the communications protocols established by the utility, each utility shall  
20 establish a system for logging all contacts between utility personnel and bidders and potential  
21 bidders. That protocol must, at a minimum, require recording the date and time of any  
22 conversation, whether telephonic or in person, the substance of that discussion and whether the  
23 Independent Monitor participated in the contact. The utility shall maintain copies of all e-mails  
24 exchanged between the utility and bidders or potential bidders, copies of all correspondence, and  
25 all such other communications as may occur regarding the solicitation, for the terms set forth  
26 below.

27 Each utility shall schedule one or more bidders' conferences to answer questions posed by  
28 potential bidders and to take comments regarding the adequacy and quality of the information

provided to bidders. All bidders' conferences must be completed at least 10 days before the release of the final bid package.

Based on the comments received, the utility, after consultation with the Staff and the Independent Monitor, shall make such changes, as it deems necessary and produce in final form its solicitation materials.

#### **D. Pre-qualification**

Participation in pre-qualification shall be a prerequisite to having a bid accepted. The utility shall begin pre-qualifying bidders at the same time it assembles the list of prospective bidders. As bidders indicate their intent to submit a bid, the utility shall provide all necessary documents to complete the pre-qualification and undertake the review of completed bidder submissions as they are received.

Bidders shall be pre-qualified for:

- Creditworthiness
- Deliverability
- Reliability
- Business reputation and experience

The utility shall notify bidders of their pre-qualification status no less than 14 days before bids are due. Any bidder that has not successfully pre-qualified by that date shall be afforded the opportunity to submit pre-qualification materials or to cure any failure to pre-qualify before the bid date.

The specific pre-qualification requirements are dependent on the products to be contracted for and will be established by the utility. Standards for pre-qualification, including minimum credit worthiness, shall be included in the solicitation materials. Information provided by bidders as part of the pre-qualification process is to be considered confidential.

1           **E.       Solicitation Cost**

2  
3           The cost of conducting each solicitation is a business expense to be borne by all bidders in  
4 a fair and equitable manner. To that end, bid fees of up to \$10,000 per bidder will be permissible.  
5 To the extent that bid fees collected exceed the incremental expenses incurred by the utility to  
6 conduct the solicitation, such excess is to be refunded to all non-winning bidders pro rata up to  
7 the amount of the bid fee actually paid by the bidder. Any costs incurred by the utility in excess  
8 of bid fees collected may be considered in subsequent regulatory proceedings.

9           Any utility requiring the payment of bid fees will be responsible for their collection and, if  
10 required, the refund of any amounts collected in excess of the costs incurred in conducting the  
11 solicitation.

12           Once a solicitation is provided to potential bidders, the utility will employ the steps laid  
13 out in the following section (V. Conducting the Solicitation) for each type of solicitation.

14           **V.   Conducting The Solicitation**

15  
16           **A.       Overview**

17  
18           In conducting the solicitation, whether by Request for Proposal or Descending Clock  
19 Auction, the utility shall employ standard sets of requirements and evaluative tools, appropriate to  
20 the type of solicitation conducted.

21           Bid evaluation will be conducted by a team of personnel including representatives of the  
22 utility and the Independent Monitor. In evaluating bids, the utility shall use a standard set of  
23 evaluative criteria, including a single fuel forecast for each type of fuel. The utility will also  
24 determine creditworthiness and deliverability using criteria that are unbiased and allow differing  
25 means of providing risk mitigation. Final bid selections will be at the sole discretion of the utility.

26           During the solicitation process, the Independent Monitor will oversee the solicitation  
27 process to ensure compliance with process requirements and to assure that evaluations are



1 conducted in an unbiased fashion. The Staff may be present during bid evaluations and may  
2 observe the solicitation process at its discretion.

### 3 **B. Bid Evaluation**

4  
5 Bid evaluations should be conducted in three phases. The first should be to rank order the  
6 bids by price using valuation methods that equalize volumetric and or duration differences on a  
7 price basis. In the case of a Descending Clock Auction for firm power at fixed prices, only pre-  
8 qualified bids will be rank ordered. In the case of unit contingent Requests for Proposals or for  
9 non-conforming offers, approaches to valuing the bids that determine an equivalent per MWh net  
10 present value of the cost of the bid to the utility by using approved annuity-based approaches may  
11 be employed.

12 Phase Two should, to the extent not determined during pre-qualification, evaluate  
13 deliverability using the network transmission assessment previously provided to the Staff and the  
14 Independent Monitor. To the extent practicable, network resource status should be assigned to  
15 appropriate bids. Network service is to be provided pursuant to each utility's OATT. Bidders  
16 may propose delivery to alternative points (i.e. points other than those specified). In such case,  
17 the utility shall determine the deliverability of the capacity and energy bid using its best efforts.  
18 If a bid imposes delivery costs on the utility, the bid price as evaluated should be adjusted to  
19 reflect those costs and a new rank order established. If the bidder is prepared to mitigate those  
20 costs at its expense, no such adjustment need be made. All assessments of alternative delivery  
21 points shall be provided to the Staff and the Independent Monitor prior to the selection of winning  
22 bids.

23 During Phase Three all other factors not previously considered are to be evaluated. These  
24 include evaluations of creditworthiness, experience and proposed exceptions to model contract  
25 terms and/or conditions.

26 To the extent necessary, the utility may conduct post bid negotiations with selected  
27 bidders to clarify bid terms or to resolve issues relating to exceptions noted in submitted bids.  
28 Additionally, the utility may conduct final negotiations with selected bidders to resolve any other

1 issues that may arise. All such meetings are to be attended, in person or telephonically, by the  
2 Independent Monitor to assure that no undue advantage is afforded any bidder. Based on the  
3 evaluations conducted, the utility will, after consultation with the Independent Monitor, and  
4 discussion with Staff, select the winning bids.

#### 5 **C. Request for Proposal Bid Evaluation Procedures**

6  
7 Bids in response to a Request for Proposal are confidential and are to be submitted in  
8 sealed envelopes to be opened simultaneously at the Commission in the presence of the utility's  
9 bid evaluators, assigned Staff personnel, and the Independent Monitor. RUCO may also attend.  
10 Bids submitted may not be withdrawn for up to 30 days or until rejected by the utility.

11 Bid evaluation will be conducted by a team of personnel including representatives of the  
12 utility and the Independent Monitor. During the evaluations, the Staff may be present. Final bid  
13 selections will be at the sole discretion of the utility.

14 If the utility determines that all bids submitted are to be rejected, it will notify all bidders  
15 of its decision to reject all bids within 21 days of the day bids were opened.

#### 16 **D. Descending Clock Auctions Bid Evaluation Procedures**

17  
18 All bids are confidential and must be firm until the auction has been completed.  
19 Electronically submitted bids must be secured and may not be reviewed except in the presence of  
20 the Independent Monitor. If feasible, bids will be reviewed at the offices of the Commission.  
21 The Staff and RUCO may also attend. However, no person selling or which may sell energy in  
22 competitive markets may review the bids (except of course for utility personnel assigned to the  
23 solicitation.)

#### 24 **E. Terms Required for Staff Recommendation**

25  
26 Based on the utility's forecasts of its power supply cost, the submitted forecast of  
27 wholesale power supply in Arizona, and such other information as it deems appropriate, the Staff,  
28 assisted by the Independent Monitor, shall establish "prices to beat" for each product solicited for

1 each utility. The “prices to beat” established by the Staff will be used for the purpose of  
2 determining whether the Staff will recommend without further analysis a finding that prices  
3 contained in any contract meeting the conditions outlined below are reasonable. For contracts not  
4 meeting the “prices to beat” conditions outlined below, the Staff will, after further analysis, make  
5 findings and recommendations relating to prudence, reasonableness and used and usefulness as  
6 appropriate in any subsequent proceedings as scheduled by the Commission.

7 In any subsequent proceedings to recover the cost of power purchased pursuant to  
8 contracts entered as a result of the initial solicitation, the Staff will, without further analysis,  
9 recommend the Commission find the prices contained in such contracts are reasonable if the  
10 Monitor determines the solicitation was conducted appropriately and the following conditions are  
11 met:

- 12 • For contracts with durations of three years or less, the Staff will recommend  
13 without further analysis approving contract prices when such prices in each year of the  
14 contract are less than the “prices to beat” established by the Staff and permit, at the  
15 utility’s sole discretion, extension of the contract for the same number of years at  
16 comparable prices and on the same terms.
- 17 • For contracts with durations longer than three years but less than eight years, the  
18 Staff will recommend without further analysis that the Commission find the prices  
19 contained in any contract reasonable when, in each year of the contract delivery  
20 period, prices for power are less than the “prices to beat” established by the Staff  
21 pursuant to the following schedule:
  - 22 - Contracts of 4 years if contract prices are less than the “prices to beat” by  
23 4% or more during each year
  - 24
  - 25 - Contracts of 5 or 6 years if contract prices are less than the “prices to beat”  
26 by 6% or more during each year
  - 27

- 1                   - Contracts of 7 years if contract prices are less than the “prices to beat” by  
2                   10% or more during each year.

- 3  
4           • For contracts not meeting the conditions outlined above, the Staff reserves the right  
5           to challenge the prudence, reasonableness or usefulness of the contract entered.

6           The above-described recommendations by the Staff do not constitute a finding by the Staff  
7           that any contract was prudent or that the utility’s power supply portfolio was prudently structured.  
8           The Staff reserves the right to contest the reasonableness of any recommended contract on its  
9           non-price terms or the utility’s portfolio in its entirety in any future proceeding. Additionally,  
10          contracts not meeting the above stated standards will not automatically be viewed by Staff as  
11          unreasonable or imprudent. The reasonableness and prudence of contracts not meeting the above  
12          criteria will need to be evaluated by Staff in subsequent proceedings.

13          The “prices to beat” set by the Staff will not be disclosed. After final bid selections are  
14          announced, the Staff will identify those winning bids that have met the conditions set forth above.

#### 15          **VI. Post Selection Requirements**

16  
17          Within 14 days of the selection of winning bids, the utility will submit to the Commission  
18          a detailed report on the process employed to conduct the solicitation and an explanation of the  
19          basis for selecting the winning bids. To the extent that confidential information is to be provided  
20          it should be noted.

21          Within 3 days of the selection of winning bids the Independent Monitor will submit a  
22          status report on the solicitation process employed by the utility to the Commission. Within 14  
23          days of the completion of the solicitation, the Independent Monitor will submit to the  
24          Commission the report described in Section II C 2 above.

25          Each utility shall maintain a complete record of all materials developed for, generated  
26          during or used in conducting the solicitation for the life of the longest contract, plus 5 years. The  
27          retained records shall include, but not be limited to, reports, internal and external  
28          communications, analyses, contracts, forecasts, bids submitted, questions received from bidders

1 and the answers provided in response, and resource plans. These materials will be available to the  
2 Staff. To the extent that the material is not subject to a confidentiality agreement, these materials  
3 will be available to the bidders upon reasonable terms and conditions.

4 Sometime after the completion of each utility's initial solicitation, the Commission Staff  
5 will commence a review of the utility's power supply portfolio to examine the prudence of that  
6 utility's planning and procurement practices, and to determine the effectiveness and efficiency of  
7 the solicitation process employed.

8 Also, sometime after the completion of the initial solicitation, the Commission Staff will  
9 commence a proceeding to review the solicitation process described in this document and will  
10 recommend such changes to the process as may be appropriate. Any refinements will be intended  
11 to improve the process and to enhance the development of a robust wholesale energy market in  
12 Arizona. Additionally, that proceeding will address the planning for future solicitations at such  
13 time and for such amounts of capacity and energy as may be needed.

#### 14 **E. Solicitation Timelines**

15  
16 On the following pages we have presented Solicitation Timelines for the two primary  
17 solicitation methodologies discussed at the workshops: The Descending Clock Auction (as  
18 proposed by APS in its initial comments on Track B Issues) and a more traditional Request for  
19 Proposals approach to power supply acquisitions. The timelines illustrate the time periods during  
20 which various required tasks are expected to be completed in order to assure that adequate power  
21 supplies are available by July 1, 2003.

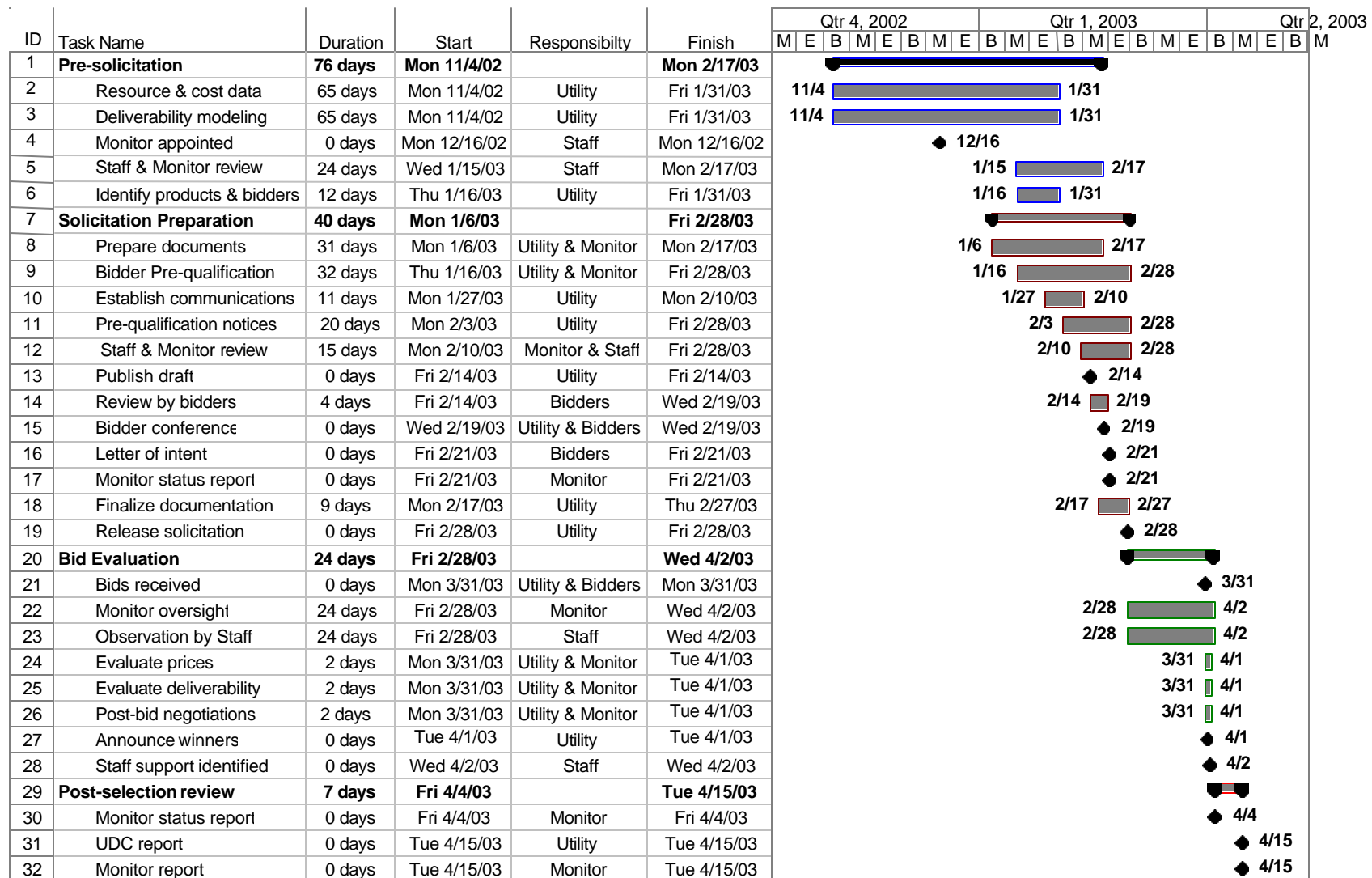
22 The timelines were reviewed with the workshop participants and there was a general  
23 consensus that they captured the major tasks that will need to be undertaken and that in the  
24 aggregate the tasks could be completed within the allotted timeframes.

# ELAPSED TIME

Preparation – Monitor Recommendation: 67 Days

Solicitation – Selection: 32 Days

## Commission STAFF SOLICITATION TIME LINE FOR DESCENDING CLOCK AUCTION

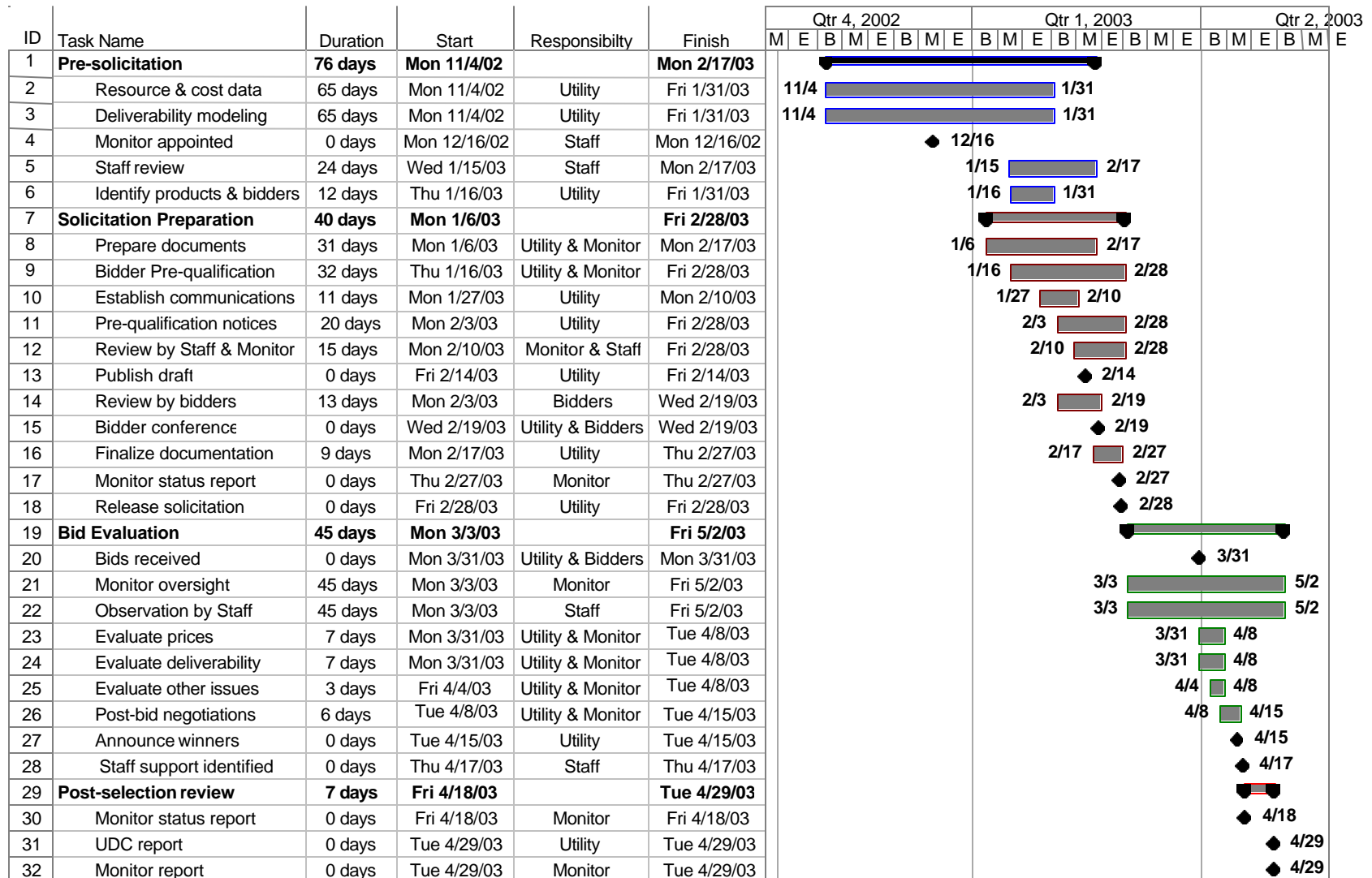


**ELAPSED TIME**

Preparation – Monitor Recommendation: 82 Days

Solicitation – Selection: 45 Days

**Commission STAFF SOLICITATION TIME LINE  
FOR  
REQUEST FOR PROPOSAL**



1     **4.     Consensus Issues Among Parties**

2             While there appeared to be few agreements among the participants to Track B when the  
3 workshops began in July 2002 the vast majority of the issues that separated the parties at that time  
4 were identified and discussed at the three workshops facilitated by the Staff. As a result of those  
5 discussions, only seven issues remain to be resolved by the Commission. Those issues are  
6 discussed in Section 5 of this Report.

7             During the workshops, the participants considered issues ranging from defining products  
8 to be solicited through defining what will indicate that the solicitation failed. In reaching  
9 consensus, the participants drew upon the experience of marketers who have participated in  
10 competitive solicitations in other states and utility personnel responsible for meeting the needs of  
11 consumers in Arizona. The Staff and its advisors directed the discussion through all necessary  
12 areas, with special attention being paid to transmission access.

13             On the following pages we set forth a list of the major issues considered during the  
14 workshop sessions and the agreements reached regarding those issues.  
15



ISSUE	AGREEMENT IN PRINCIPLE
1. What is the appropriate way to structure the solicitation process?	<ul style="list-style-type: none"> <li>1. Structure must be transparent</li> <li>2. Structured to meet goals of: <ul style="list-style-type: none"> <li>a. System reliability</li> <li>b. No increase in consumer risk</li> <li>c Reasonable prices to consumers</li> <li>d. Environmental standards met</li> </ul> </li> <li>3. Structure must be flexible <ul style="list-style-type: none"> <li>a. Tailored to UDC</li> <li>b. Change over time</li> <li>c. Acquisition of multiple products from diverse generating sources should be encouraged. Multiple contracts from diverse suppliers are appropriate.</li> </ul> </li> </ul>
2. Are there power supplies that should be exempt from, or treated differently in, a competitive solicitation?	<ul style="list-style-type: none"> <li>1. Exempt from competitive solicitation: <ul style="list-style-type: none"> <li>a. Existing contracts</li> <li>b. Future QF contracts</li> </ul> </li> </ul>
3. What role should Least Cost Planning play in competitive markets?	<ul style="list-style-type: none"> <li>1. UDC will continue to forecast load &amp; develop supply portfolio</li> <li>2. Least Cost Panning will not require self-build by UDC</li> </ul>
4. Who should bear price risks?	<ul style="list-style-type: none"> <li>1. Assigning risk to UDC increases UDC cost</li> <li>2. Assigning risk to bidders will increase bid prices</li> <li>3. Contract fuel adjustment mechanisms are appropriate</li> <li>4. UDC will be free to seek cost recovery in future proceedings</li> </ul>
5. Should there be a standard approach to competitive solicitations?	<ul style="list-style-type: none"> <li>1. Process should accommodate all possible products</li> <li>2. Same process should be used for all UDC's.</li> <li>3. Load growth is contestable</li> <li>4. Unmet needs are contestable</li> <li>5. Contestable load will change over time</li> <li>5. Affiliated suppliers may compete for load</li> </ul>

ISSUE	AGREEMENT IN PRINCIPLE
6. How should UDC's meet the Environmental Portfolio Standards?	<ol style="list-style-type: none"> <li>1. Bidders should not be required to include EPS in each bid.</li> <li>2. EPS, Renewables and DSM should be permitted to bid in first solicitation, but no mandated "bonus points" awarded in review process.</li> <li>3. Any EPS not acquired through this solicitation should be acquired in a separate process.</li> </ol>
7. How should a competitively procured power supply portfolio be structured?	<ol style="list-style-type: none"> <li>1. Current transmission allows some level of competitive solicitation</li> <li>2. Must address load shape</li> <li>4. Product diversity</li> <li>5. Term diversity</li> <li>6. Deliverability must be considered</li> <li>7. Ancillary services are not to be solicited in the first solicitation as separate products.</li> <li>8. Ancillary services should be phased in accordance with Standard Market Design.</li> <li>9. Slice of system should not be bid in first solicitation.</li> <li>10. Slice of system should not be included in the first solicitation.</li> <li>11. Unit contingent bids may be used in 2003 Solicitation</li> <li>12. Bids for multiple years should be considered in 2003 Solicitation</li> </ol>
8. What are the acceptable pricing regimes?	<ol style="list-style-type: none"> <li>1. Bidders should have option to bid pricing structure.</li> <li>2. UDC not required to accept a particular structure.</li> <li>3. For first solicitation, UDC will use pricing structure and terms approved by Commission.</li> </ol>
9. Does a competitive solicitation address market power concerns?	<ol style="list-style-type: none"> <li>1. Market power is mitigated by permitting bidders to identify equivalent transmission points</li> <li>2. Deliverability of load must be verifiable</li> <li>3. No preference to transmission should be given to UDC affiliates</li> <li>4. Bidders' proposed transmission path cannot displace contract load or native load.</li> <li>5. Through the use of equivalent delivery points, swaps should be permitted.</li> </ol>

ISSUE	AGREEMENT IN PRINCIPLE
10. Who can participate in the solicitation?	1. Solicitation open to all bidders.
11. Are there requirements to qualify to bid?	<ol style="list-style-type: none"> <li>1. Pre-qualification of bidders should be required</li> <li>2. All pre-qualification requirements should be disclosed before bidding.</li> <li>3. Amount of any bid fee imposed on bidders to be disclosed before bidding.</li> <li>4. Minimum qualification should be demonstration to provide creditworthiness.</li> </ol>
12. How should bids be evaluated?	<ol style="list-style-type: none"> <li>1. Evaluation criteria disclosed with solicitation: <ol style="list-style-type: none"> <li>a. Draft contract</li> <li>b. Review process</li> <li>c. Specific criteria</li> <li>d. Bidder &amp; product requirements to close.</li> </ol> </li> <li>2. Commission Staff and Monitor should: <ol style="list-style-type: none"> <li>a. Review solicitation before issuance</li> <li>b. Monitor bid review by UDC</li> <li>c. Monitor selection process</li> <li>d. Review bids and final selection(s)</li> <li>e. Assure fairness &amp; arms-length review</li> </ol> </li> </ol>
13. Failure of the solicitation	<ol style="list-style-type: none"> <li>1. Solicitation will be a failure if: <ol style="list-style-type: none"> <li>a. No consumer benefit</li> <li>b. No power contract is signed</li> <li>d. Commission determines the process, as employed, was flawed</li> <li>e. Market power exacerbated</li> <li>f. Not enough capacity to meet load</li> </ol> </li> <li>2. If solicitation fails, Commission should require immediate new solicitation</li> <li>3. UDC should retain solicitation records beyond life of contract</li> </ol>

1     **5.     Unresolved Issues Among Parties**

2           At the conclusion of the sixth day of workshops, the participants agreed on a list of seven  
3     unresolved issues to be presented to the Commission. The list was prepared to include all  
4     unresolved issues raised by any individual participant who was present at the workshop on  
5     September 27, 2002. Accordingly, the issues identified by the Staff and referenced in the Third  
6     Procedural Order were all of the issues the workshop participants claimed were unresolved at the  
7     end of the workshops. While discussed below, the Staff does not agree that all of these issues  
8     should be addressed in this proceeding. The seven issues presented were:

- 9           A. What portion of APS' load represents its unmet needs?  
10          B. How the Staff will determine and use the "price to beat".  
11          C. The timing of Commission prudence evaluation of solicited contracts.  
12          D. Should the utility or a third party conduct the solicitation in 2003?  
13          E. The standards of conduct governing utility-affiliate communications.  
14          F. Whether a least-cost planning process should be adopted by the Commission.  
15          G. Whether the Commission should initiate a proceeding to address DSM and  
16          Environmental Risk Mitigation.

17  
18     The Third Procedural Order on Track B issues catalogs all of the issues presented by the  
19     individual parties at the procedural conference held on October 2, 2002. Many of the issues are  
20     variations of the seven issues listed above.

21           The procedural order also identifies issues that the Staff addressed in the Solicitation  
22     Proposal and discussed with the workshop participants. The Staff position on how those issues  
23     should be addressed by the Commission are set forth in the Solicitation Proposal, and a cross  
24     reference to that document is provided for ease of reference.

1           **A. What portion of APS' load represents its unmet needs?**

2           This is the penultimate issue to be resolved by the Commission. Clearly, there must be a  
3 clear identification of the capacity and energy that will be required in order to serve load before a  
4 solicitation can occur. The Staff believes the solicitation in 2003 should be for the energy and  
5 capacity the utility cannot supply from generation assets that are included in the utility's rate base,  
6 from contracts in effect, as of September 1, 2002, and from generation sources it must take as a  
7 result of law or regulation (QF's and Environmental Portfolio sources). This unmet need for each  
8 of the next 4 years should be the minimum amount that is included in the solicitations in 2003.

9           In Section I, B of the Staff proposed solicitation process, charts are provided showing  
10 Staff's current estimates of the capacity and energy needs for the next 4 years that should be  
11 deemed to be contestable loads in the 2003 solicitations for TEP and APS. These estimates were  
12 determined from information provided by the utilities during the workshops. In the case of TEP,  
13 the figures were provided by the utility. APS declined to provide energy and capacity estimates  
14 requiring the Staff to calculate the figures from information provided by the utility, which the  
15 utility now claims, is erroneous. Staff may, upon receipt of revised APS data, schedule an  
16 additional workshop to review APS' submitted data with the Track B participants and if  
17 appropriate revise the estimates contained in this Report. The Staff further believes that these  
18 estimates will need to be adjusted periodically to reflect changes in load, forecasted load, or  
19 power supply identified over time.

20           **B. How the Staff will determine and use the "price to beat".**

21  
22           During the workshops, some participants expressed the desire to have prompt Commission  
23 review of selected bids, in order to reduce regulatory uncertainty resulting from the possibility of  
24 a future disallowance of related costs. Staff did not agree that all contracts awarded under the  
25 solicitation should be automatically approved by the Commission. However, Staff developed the  
26 price to beat concept to provide certainty of Staff support for cost recovery as an alternative to an  
27 expedited Commission review process.

1       The Staff will calculate the price to beat with the assistance of the independent monitor  
2 before the solicitation is released to prospective bidders. Available information on the forecast  
3 cost of delivered electricity in the Arizona market will be used to develop the price to beat. The  
4 Staff will review multiple sources of data to be provided by the utilities and any participant in the  
5 process who chooses to supply such data in establishing its price to beat. The price to beat is  
6 discussed in Section V, E (Terms Required for Staff Recommendation) of the proposed Initial  
7 Solicitation Process.

8  
9       The “price to beat” calculated by the Staff will be used by the Staff to determine whether  
10 Staff will support the prices contained in any contract, without further investigation, when the  
11 utility seeks recovery of related costs from consumers. The price to beat will be used only by the  
12 Staff, and will not be disclosed to the utility or to bidders, even after the solicitation is completed.  
13 In this way, the chance that the price to beat will influence the evaluation process or the selection  
14 decisions made by the utilities will be minimized. After the solicitation is completed and  
15 contracts have been executed, the Staff will announce whether any of the winning bids have  
16 satisfied the price to beat criteria and, in turn, whether any contracts executed will have the  
17 support of the Staff in a future cost recovery proceeding.

18       **C. The timing of Commission prudence evaluation of executed contracts.**

19  
20       In the opinion of the Staff, the Commission should review the contracts entered into as a  
21 result of the solicitation at such time as the utility seeks to recover the associated costs from  
22 customers.

23       During the Track B workshops some parties urged Commission review before contracts  
24 were executed, arguing that this would remove the risk to both utilities and merchants of  
25 regulatory disallowance and, presumably, result in lower cost bids. The Staff is interested in  
26 ensuring that consumers receive service at the best price, but believes that factors beyond price  
27 alone need to be considered in determining the reasonableness and prudence of decisions made by  
28 regulated utilities. At least in the case of this first solicitation the Staff believes that sufficient

time must be allocated to a review of each utility's power supply portfolio resulting from the solicitation to fully evaluate the success of the solicitation process implemented and the reasonableness of the decisions made by the utility in the solicitation.

**D. Should the utility or a third party conduct the solicitation in 2003?**

The solicitation should be conducted by the utility barring evidence of impropriety by the utility. The procurement of energy and capacity to meet the needs of consumers is the responsibility of the utility. The judgment of a third party should not, in the ordinary situation, be substituted for that of the utility. However, the Commission should, through the Staff and an Independent Monitor, review the actions of the utility and be prepared to appoint a third party to conduct the solicitation should the utility fail to conduct a fair and transparent solicitation. In particular, should there be any evidence of improper contact between the utility and an affiliate, the Commission should have a third party conduct the solicitation if it is determined that the contact was a material violation of the standard of conduct.

**E. The standard of conduct governing utility-affiliate communications.**

For the solicitation to be successful all bidders must be treated equally, starting with access to personnel assigned to the solicitation and information pertinent to the utilities' power supply requirements and delivery capabilities. To accomplish this, an enforceable standard of conduct controlling contact between any person including affiliated companies, their personnel and contractors, that may bid in the solicitation and the utility must be established. Absent such standards, bidders will lack confidence in the process, which may result in a less robust bidding process.

The standards must require that all contact between the utility and its affiliates be on the same terms and under the same conditions as with all other bidders. That is, there should be no contact between the utility and affiliates that may bid in the solicitation, except through the communications protocol established for bidders. The key elements of the Staff proposed protocol is set forth in Section IV C of the Staff proposal (Section 3D). The protocol would

1 require the utility to establish a solicitation team by January 1, 2003, and prohibit contact relative  
2 to the solicitation with the team by any individuals associated with any affiliate. The Staff  
3 anticipates that the team would include personnel from the utility and such other personnel as the  
4 utility may require and that those persons would be barred from assisting any affiliate in the  
5 evaluation of the solicitation or preparing a bid in response to the solicitation.

6 The utility should be required to prepare a draft standard of conduct and provide it to the  
7 Staff and the Independent Monitor as soon as possible as part of the pre-solicitation information  
8 and document preparation process. Once the Staff and the Independent Monitor have completed  
9 their review of the draft standard of conduct submitted by the utility and discussed changes with  
10 the utility, the draft should be shared with the prospective bidders. Their input on the draft  
11 standard of conduct will be reviewed by the Staff, the Independent Monitor and the utility. Upon  
12 completion of that review, the utility should make all changes to the draft standard of conduct  
13 deemed necessary and publish the final standard of conduct to the solicitation team and to all  
14 interested parties as part of its solicitation information. As discussed above, the Staff believes the  
15 utilities should begin that process in November 2002 and have all documents, including a draft  
16 standard of conduct, completed by the end of January 2003.

17 An acceptable standard of conduct will, at a minimum, address the following:

- 18 • Personnel who may be assigned
- 19 • Roles and Responsibilities
- 20 • Maintenance of confidential information
- 21 • Communications with affiliated entities and persons
- 22 • Equal access to information for all persons
- 23 • No undue advantage included in solicitation terms and conditions
- 24 • Standards for evaluations
- 25 • Protocols for logging communications
- 26 • Records maintenance, including communications records
- 27 • Procedures for monitoring by Staff and independent monitor
- 28 • Procedures for verifying compliance, internal and external



1           **F. Whether a least-cost planning proceeding should be adopted by the Commission.**

2  
3           Least-cost planning was an issue raised by RUCO during the workshops. No other  
4 workshop participant joined RUCO in making this observation. Staff believes that least cost  
5 planning is not an issue to be explored in this initial solicitation proceeding.

6           **G. Whether the Commission should initiate a proceeding to address DSM and**  
7           **Environmental Risk Mitigation.**

8  
9           The Law Fund requested that a proceeding be opened to examine the issue of how and  
10 when a solicitation for DSM and Environmental Risk Mitigation should be factored into the  
11 solicitation process. Staff believes that DSM and Environmental Risk Mitigation should not be  
12 addressed by the Commission in this proceeding. Also, the Commission need not decide at this  
13 time whether a separate proceeding is necessary to examine these issues.

14           Pursuant to the Staff proposed process, bidders would be free to submit bids that include  
15 DSM or Environmental Risk Mitigation in response to a product solicitation, and utilities will be  
16 required to evaluate those bids on the same basis as they evaluate all other bids. Several  
17 participants in the Track B workshops have suggested that bidders should be required to include  
18 in their bids an environmental component. Staff believes that bidders should not be required to  
19 include DSM or Environmental Risk Mitigation components as a part of their response to a  
20 solicitation but may do so if they deem it appropriate.

21   **6. Lessons To Be Learned From The Initial Solicitation**

22  
23           While the proposed process described above is comprehensive and based on successful  
24 models from other jurisdictions, the unique circumstances that exist in Arizona will undoubtedly  
25 require that modifications to the process be made. The Staff has therefore planned to conduct  
26 thorough post solicitation reviews of the process each utility employs to determine what changes,  
27 if any, will need to be made to the process adopted by the Commission in this proceeding. While

1 the initial solicitations will be for all unmet needs presently identified, the Staff intends to review  
2 the appropriateness of the process for meeting future needs as they present themselves. The  
3 creation of an ISO or RTO or the ramifications of FERC's SMD NOPR will also need to be  
4 considered and factored into changes that may be needed to assure that the solicitation process  
5 can continue to meet the goals established by the Staff.

6 The Staff anticipates that codes of conduct and rules concerning affiliated transactions will  
7 also be reviewed.

8 The Staff intends to review and, if necessary, to amend the process to reflect lessons  
9 learned regarding the effectiveness of the various methods employed by the utilities to solicit  
10 bids. In particular, the communications protocols established to manage relations with affiliated  
11 companies, the power supply products solicited, the contract durations and terms and conditions  
12 sought and the tools used to solicit and evaluate bids submitted will be reviewed.

13 Finally, the Staff will evaluate the time allocated to each phase of the process to determine  
14 whether adequate time was allocated to allow for preparation of all required data, development of  
15 specifications and bids and for comprehensive evaluations of all bids received.

## 16 **7. Subsequent Solicitations**

17  
18 After completion of the initial solicitations, the Staff will conduct the reviews described  
19 above in Chapter 6. To the extent that the Staff determines that changes to the process are  
20 required, it will recommend such changes to the Commission.

21 While presented as the "initial" solicitation process, the Staff believes the process is  
22 comprehensive and will be adequate to manage future solicitations to acquire power supplies to  
23 meet unmet needs identified in the future or to meet needs of the utility in the event that asset  
24 divestiture may be approved by the Commission. However, the creation of an ISO or RTO or the  
25 implementation of FERC's SMD proposal may significantly alter the dynamics of competitive  
26 wholesale markets and would likely require significant amendments to the process, particularly

1 with regard to the roles and responsibilities of the process participants and the range of power  
2 supply products to be acquired.

## 3 **8. Appendix One To ACC Staff Report On Track B: An Overview Of Competitive** 4 **Solicitation In Selected States For Wholesale Supply 2002**

### 5 6 INTRODUCTION

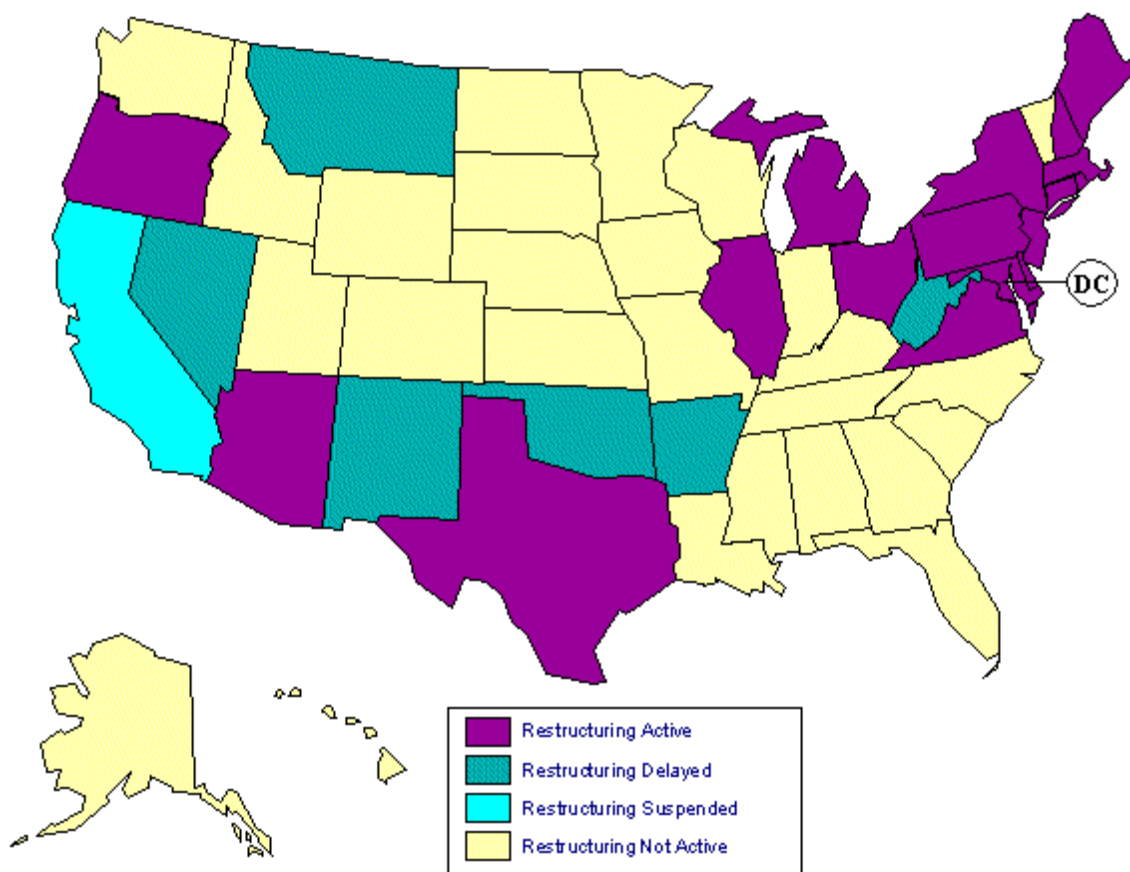
7  
8 As the restructuring of the electric utility industry in the United States has evolved,  
9 regulators have examined various models in order to find the model that best provides sustainable  
10 benefits to consumers from development of competitive markets. In some states, the focus has  
11 been on retail choice accompanied by mandatory divestiture of generating assets. In other  
12 jurisdictions, retail choice was encouraged without divestiture. Still other jurisdictions have  
13 determined that neither retail choice nor divestiture is appropriate at this time, but that power  
14 supply additions should be competitively procured. With each model, the utility retained the  
15 responsibility for providing service to those customers who were not served by another supplier.

16 This review of the regulatory approaches of selected other state commissions concentrated  
17 on how those commissions used competitive bidding processes to meet default service  
18 obligations. A second part of the review examined what restrictions, if any, were imposed by  
19 regulators on wholly-owned affiliates of utilities in competitive solicitations.

20 In summary, each state that implemented competitive solicitation for wholesale supply of  
21 electricity adopted an approach unique to that jurisdiction. For example, states that required  
22 divestiture of generation implemented solicitation programs designed to procure full system  
23 requirements, typically with slice-of-system all requirement contracts, while utilities with owned-  
24 generation used solicitation programs to supplement their installed capabilities. The processes  
25 adopted were also significantly dependent on the state of development of the RTO, ISO, or power  
26 pool in which the affected utilities operated. There is no “perfect model” that can be adapted  
27 from another state for use in Arizona. Rather, the experience from a number of states should be

1 drawn upon, modified, and applied to the needs of Arizona to fashion a solicitation program that  
2 will meet the needs of this state.

3 Status of State Electric Industry Restructuring Activity  
4 -- as of July 2002 --  
5



6  
7  
8 As of June 2002, twenty-four states and the District of Columbia have either enacted  
9 enabling legislation or issued a regulatory order to implement retail access. Each state's retail  
10 access schedule varies according to its unique legislative mandates and regulatory orders. The  
11 information in the "Status of State Electric Industry Restructuring Activity Map" was gathered  
12 from state public utility commissions, state legislatures, and utility company web pages. The map  
13 was prepared by the Energy Information Administration of the U.S. Department of Energy.

## DISCUSSION

Arizona has challenges that are different from those other states had to address when implementing a wholesale solicitation process. Most states that have moved forward in this area have had well developed and integrated transmission pools, providing the ability to balance needs and reserves with a high degree of certainty. Typically, those pools have well defined load management processes. In many of those states, the regulators have established rules and regulations to ensure that the wholesale power purchases made by utilities do not impair system reliability and are contracted for in a manner that is fair, equitable and provides tangible benefits for consumers.

Following are brief descriptions of the approaches adopted by several states that have addressed wholesale solicitation requirements as part of restructuring the electric utility industry.

### **Colorado**

#### Background

Colorado has repeatedly rejected legislation to restructure the electric utility industry. Instead, the PUC, by rule making, requires utilities to use competitive solicitation to meet the Integrated Resource Plan (IRP) standard established by the Commission.

#### Wholesale solicitation

Utilities retain the obligation to procure capacity and energy to meet the needs of consumers. Each utility must file an IRP with the Commission (Code of Colorado Regulations 723-3, Rules 3600-3615), which includes a forecast and needs assessment every four years. The IRP must also include the draft RFP the utility will use to solicit energy and capacity bids. Under the recently amended rules, the PUC will review the resource plan and approve the plan for the utility before competitive solicitations are conducted, including the plan for competitive solicitation. Approval by the PUC creates the presumption that the utility actions are prudent. However, the rules expressly state

1 that approval of a plan carries no presumption that the selection of specific resources are  
2 prudent. The obligation to conduct a solicitation and to acquire resources and to prove  
3 that costs should be recovered *after the fact* remains with the utility. Public comments on  
4 the IRP are not required.

## 6 **Florida**

### 7 Background

8 Before an electric utility can build an electrical power plant that generates more than 75  
9 megawatts of steam or solar generation, the electric utility must conduct a solicitation for  
10 wholesale power and secure a determination of need from the Florida Public Service  
11 Commission.

12 In making its need determination, the PSC takes into account:

- 13 1. the need for electric system reliability and integrity;
- 14 2. the need for adequate electricity at a reasonable cost; and
- 15 3. whether the proposed plant is the most cost-effective alternative available.

16 The need determination process enables the PSC to verify that more electricity generation  
17 capacity is needed to prevent unnecessarily burdening consumers with the costs associated  
18 with constructing new power plants.

19 The intent behind the bidding rule is to provide consumers with benefit when, through an  
20 open and fair process, the supply side of the wholesale energy equation is subject to  
21 competitive bidding.

### 22 Wholesale solicitation

23 Prior to filing a need determination petition to build an electrical power plant, an electric  
24 utility is required to solicit and evaluate competitive proposals for supply-side alternatives  
25 by issuing a Request for Proposals (RFP).  
26 The PSC promulgated rules (PSC Rule 25-22-082) regulating the process by which  
27 capacity additions are authorized. The rules include evaluation of supply-side alternatives  
28 and detailed requirements that the utility must meet as part of a solicitation through a

1 request for proposal process. The RFP is filed with the PSC, which monitors the  
2 solicitation process, while the utility conducts the solicitation. Only parties to the  
3 solicitation are permitted to challenge the outcome of the solicitation. Utilities are  
4 permitted to bid in a solicitation.

5 Presently, the PSC is considering reviewing the solicitation process because, since the  
6 rules adoption in 1994 no contracts have been awarded to competing proposals, that is, the  
7 utility has won all of the contracts itself.

## 8 9 **Maine**

### 10 Background

11 As part of the 1997 restructuring of the electric utility industry, the legislature directed the  
12 Maine Public Utilities Commission (MePUC) to promulgate rules for the provision of  
13 standard offer service. In January 2001, the MePUC issued an order adopting detailed  
14 rules. Pursuant to those rules, the MePUC has, in the first instance, responsibility for  
15 conducting a solicitation to meet standard offer service obligations in the state. Electric  
16 companies only have the obligation to procure electricity and capacity in the event the  
17 MePUC notifies the company of its failure to procure the standard offer needs. Electric  
18 utilities retain the obligation to provide standard offer service to customers who chose not  
19 to switch providers.

### 20 Wholesale solicitation

21 Chapter 301 of the MePUC rules provides for the commission to conduct requests for  
22 proposal to meet the standard offer requirement. The rules limit sales by affiliates to no  
23 more than 20% of the amount of the solicitation, and the initial solicitation was only for  
24 contracts of one year. Bidders are permitted to bid for portions of the requirement in  
25 multiples of 20% of the total solicitation.  
26

## **Maryland**

### **Background**

Pursuant to settlements reached with each of Maryland's electric utilities, generation was deregulated and retail customer choice was implemented beginning in 2000. Each utility retained the responsibility to provide Standard Offer Service for finite periods at rates that were frozen by the Commission for various classes of customers through as late as 2006. Each utility was given complete discretion to arrange electric supply, but for all SOS service to be rendered from 2004 through 2006 that supply has to be procured through competitive wholesale markets. No power supply contract executed to serve SOS customers could contain prices that exceeded the Price Freeze rates established by the Maryland Commission.

### **Wholesale solicitation**

The Maryland PSC has not established rules or regulations mandating the conduct of power supply solicitations. Rather, through settlements with individual utilities, the Commission defined the responsibilities of each utility to acquire power in competitive solicitations to serve standard offer service customers.

## **Massachusetts**

### **Background**

The Massachusetts Department of Telecommunications and Electricity's (DTE) final decision to officially open the retail electricity market to competition in March 1998 was issued in January 1997. In early 1998 the DTE issued rules establishing licensing and disclosure requirements for retail suppliers and standard offer service and issued rules for distribution, default generation services, standard offer generation, aggregation requirements, and ownership of meters. During 2000 the DTE issued an order that allowed utilities to base their rates for default service on wholesale bid prices, beginning in January 2001. Utilities began issuing competitive bids seeking 6-month to 1-year contracts for the



power needed to serve their default service customers. Default service is defined as those customers who have left their competitive supplier, or are new to the utility's territory.

### Wholesale solicitation

Massachusetts' four distribution utilities are each a member of NEPOOL, an integrated transmission pool with sophisticated load management and settlement procedures. Massachusetts required full divestiture of generating assets as part of electric utility restructuring. Each distribution company is responsible for default service. Each distribution company conducts a solicitation every 6-12 months and solicits bids for a subsequent 6-12 month period. Typically, there is a short round and then a final round of bidding. The issue of wholly-owned subsidiaries with load is not an issue in Massachusetts and, accordingly, there are no specific prohibitions on affiliate sales of power. However, regulators do monitor solicitations and if an affiliate were to bid, the solicitation would receive closer review. The regulators do not receive copies of the RFPs issued by the distribution companies.

## **New Jersey**

### Background

The Electric Discount and Energy Competition Act of 1999 ("EDECA" or "Act"), N.J.S.A. 48:3-49 et seq., provides that for at least three years from the starting date of electric retail choice and until the New Jersey Board of Public Utilities (the Board) finds it to be no longer necessary and in the public interest, electric public utilities shall provide basic generation service (BGS). N.J.S.A. 48:3-57(a).

By Order dated June 6, 2001, the Board directed the four electric distribution companies ("EDCs") in New Jersey to each file specific proposals to implement an RFP process for BGS for Year 4 of the Transition Period.

### Wholesale solicitation

The four New Jersey electric distribution utilities filed a generic proposal for the provision of Basic Generation Service. The generic proposal recommended a simultaneous, multi-round, descending clock auction format.

1 The EDCs jointly proposed a single Auction Process for the procurement of supply to  
2 meet the full electricity requirements (i.e., energy, capacity, ancillary services,  
3 transmission, etc.) of retail customers that had not chosen a Third Party Supplier. Under  
4 the proposal, the BGS Loads of all EDCs would be bid out in the same auction. The  
5 annual BGS retail load of each EDC is considered a separate “product.”

6 The EDCs proposed that an Independent 3rd party conduct the Auction.

7 After hearings, the Board authorized the proposed process with modifications and  
8 assigned its consultant to monitor the auction.

9 Subsequent to the auction the Board commenced a proceeding to review the outcome of  
10 the process employed and to consider modifications to the process suggested by the  
11 Auction Manager, the Board’s consultant and other persons who submitted comments.

## 13 **Pennsylvania**

### 14 Background

15 The Electricity Generation Customer Choice and Competition Act was enacted in 1996.  
16 The law allowed consumers to choose among competitive generation suppliers beginning  
17 with one third of the State's consumers by January 1999, two thirds by January 2000, and  
18 all consumers by January 2001. Utilities were required to submit restructuring plans by  
19 September 1997. Utilities are required to be providers of last resort and customers have  
20 the right to return to default service at any time through 2010.

### 21 Wholesale solicitation

22 The distribution company is required to meet its obligation as provider of last resort by  
23 purchasing required amounts of energy and capacity from wholesale sources.  
24 Procurement from affiliated generating companies is permitted. The utility retains  
25 discretion to determine the source of wholesale energy and capacity. As of January 1,  
26 2001, the utility’s recovery from customers is limited, through the terms of approved  
27 settlement agreements, to pre-established rates for each class of ratepayer.

## Texas

### Background

Restructuring legislation was enacted in 1999 to restructure the Texas electric industry allowing retail competition. The bill required retail competition to begin by January 2002. Rates are frozen for 3 years, and then a 6 percent reduction will be required for residential and small commercial consumers. This will remain the "price to beat" for five years or until utilities lose 40 percent of their consumers to competition. Utilities must unbundle into 3 separate categories, using separate companies or affiliate companies, the generation, the distribution and transmission, and the retail electric provider. Utilities will be limited to owning and controlling not more than 20 percent of installed generation capacity in their region (ERCOT).

The PUC adopted rules for the provider of last resort for when competition began in early 2002. The provider of last resort is required to provide to consumers no longer served by their provider of choice service at a fixed price. A competitive bidding process will designate the last resort providers for each consumer class. Bidding was completed by June 1, 2001.

During 2001, utilities in Texas began the process of auctioning part of their generating capacity. The auction is designed to increase the pool of available power for new retail suppliers entering the market, prevent market power, and promote competition in electricity markets.

### Wholesale solicitation

As part of the restructuring of the market, utilities are required to acquire 15% of their capacity requirement through auction. The utility has the responsibility to procure the necessary capacity and energy, adhering to the rules established by ERCOT. Capacity in addition to the mandated capacity auction is procured through solicitation and secured by bilateral contracts.

## **9. Appendix Two: APS' Response To Staff's October 15, 2002, Data Request**



Jana Van Ness  
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October 22, 2002

VIA FACSIMILE

Janet F. Wagner  
Attorney, Legal Division  
Arizona Corporation Commission  
1200 W. Washington  
Phoenix, Arizona 85007

RECEIVED

OCT 23 2002

LEGAL DIV.  
ARIZ. CORPORATION COMMISSION

RE: ARIZONA CORPORATION COMMISSION STAFF'S FIRST SET OF DATA REQUESTS  
TO ARIZONA PUBLIC SERVICE COMPANY PURSUANT TO ACC DOCKET NO. E-00000A-02-0051,  
ET AL.

Dear Ms. Wagner:

Enclosed is a copy of Arizona Public Service Company's ("APS") responses to the Arizona Corporation Commission Staff's (Staff's) First Set of Data Requests dated October 15, 2002.

If you or your staff have any questions, please feel free to call me.

Sincerely,

Jana Van Ness  
Manager  
Regulatory Compliance

Attachment

JVN/vid

Cc: With Attachments  
Matt Rowell, ACC  
Christopher Kemply, ACC  
Thomas Mumaw, Esq. PWCC

**STAFF'S FIRST SET OF DATA REQUESTS TO ARIZONA PUBLIC SERVICE IN  
DOCKET NO's. E-00000A-02-0051, E-01345A-01-0822, E-00000A-01-0630  
AND E-01933A-02-0069 (TRACK B)  
October 15, 2002**

MR 1.1            Please provide all forecasts of APS' total *retail* load capacity and energy for the following years: 2003, 2004, 2005, 2006, and 2007. For each forecast provided, please describe the purpose for which it was prepared, its strengths and weaknesses, and the degree of reliance that APS has placed upon it.

RESPONSE:

See attached table. [Attachment Staff DR 1, Q. MR1.1]

APS prepares forecasts of retail customer peak demands and energy requirements to support the operational, financial, and system improvement planning needs of the company. Each of the forecasts presented here has influenced the company's view of what actions are required to best meet the anticipated customer demands. APS places heavy reliance on each forecast to develop its plans, but recognizes that each forecast is inherently uncertain and plans accordingly.

Each forecast is typically characterized by the same set of strengths and weaknesses. Strengths include: preparing each forecast with sufficient detail such that actual results can be compared against projections and resulting deviations can be used in the preparation of subsequent forecasts; having a management review of the key assumptions underlying each forecast for consistency and, to the extent practical, accuracy; and the knowledge of how much uncertainty may be reflected in each forecast. Weaknesses are generally to be found in the areas of greatest volatility and uncertainty, such as the difficulty in accurately forecasting net population migration to Arizona, sudden changes to customer behavior, actual weather conditions, and customer coincident peak load factors.

## Response to Staff Data Request MR 1.1 Dated October 15, 2002

<u>Description</u>	<u>Date</u>	<u>Retail Energy Load in Gigawatthours</u>					<u>Retail Peak Load in Megawatts</u>				
		<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
1993 Long-Range Forecast	Feb 1993	22,157					4,354				
1994 Long-Range Forecast	Feb 1994	21,100	21,581				4,339	4,419			
1995 Long-Range Forecast	Jun 1995	24,273	24,922	25,561			4,725	4,836	4,945		
1996 Long-Range Forecast	Apr 1996	24,429	25,084	25,746	26,381		4,666	4,776	4,890	4,992	
1997 Long-Range Forecast	Feb 1997	25,064	25,736	26,414	27,080	27,781	4,888	5,005	5,122	5,231	5,347
1998 Long-Range Forecast	Feb 1998	25,590	26,369	27,176	27,964	28,797	5,288	5,445	5,611	5,761	5,918
1999 Long-Range Forecast	Apr 1999	25,689	26,530	27,370	28,195	29,068	5,509	5,700	5,890	6,078	6,276
2000 Budget	Oct 1999	25,233	26,074	26,918	27,757	28,611	5,609	5,786	5,981	6,179	6,378
2000 Long-Range Forecast	Apr 2000	26,339	27,376	28,326	29,187	30,048	5,852	6,073	6,294	6,498	6,698
2001 Budget	Oct 2000	26,845	27,860				5,945	6,164			
2001 Long-Range Forecast	Apr 2001	26,954	27,914	28,813	29,723	30,641	6,077	6,325	6,538	6,755	6,973
2002 Budget	Oct 2001	26,552	27,871	29,271	30,744	32,295	5,946	6,228	6,652	6,994	7,354
2002 Long-Range Forecast	Apr 2002	26,200	27,526	28,770	29,902	31,108	5,928	6,260	6,563	6,804	7,081
2003 Budget	Oct 2002	26,289	27,635	28,790	29,967	31,175	5,717	6,016	6,262	6,515	6,780

**STAFF'S FIRST SET OF DATA REQUESTS TO ARIZONA PUBLIC SERVICE IN  
DOCKET NO's. E-00000A-02-0051, E-01345A-01-0822, E-00000A-01-0630  
AND E-01933A-02-0069 (TRACK B)  
October 15, 2002**

MR 1.2            Please specify whether there is an "official" forecast(s), i.e., one which APS uses for any formal purpose. If so, please identify it and describe its use. If there are more than one, please identify and describe each.

RESPONSE:

APS typically prepares two "official" forecasts each year: a 10-year forecast in the spring to support long range planning efforts and a forecast in the fall to support near-term budget and operational plan development. Historically, this has been for a 3-year period, although this year's budget forecast covers additional years. Of course, APS also has an on-going planning process that requires these forecasts to be modified and updated on a more periodic basis. These updates are generally adopted and used by the various planning groups within the Company to update their own plans.

**STAFF'S FIRST SET OF DATA REQUESTS TO ARIZONA PUBLIC SERVICE IN  
DOCKET NO's. E-00000A-02-0051, E-01345A-01-0822, E-00000A-01-0630  
AND E-01933A-02-0069 (TRACK B)  
October 15, 2002**

MR 1.3            Please list each rate-based plant that APS uses to serve its retail load. For each plant listed, please specify the plant's capacity and capacity factor.

RESPONSE:

See attached table. [Attachment Staff DR 1. MR 1.3]



RESPONSE: MR 1.3

APS Generating Unit Historical Capacity Factor  
2000 -2002

Unit	2002 SUMMER CAPACITY (MW)	ANNUAL CAPACITY FACTOR (%)		
		2000	2001	2002
Palo Verde 1	361.7	100.4	87.8	90.0
Palo Verde 2	361.7	87.2	92.6	91.0
Palo Verde 3	362.9	90.3	83.9	100.8
Four Corners 1	170.0	87.7	81.5	77.6
Four Corners 2	170.0	90.6	80.9	90.4
Four Corners 3	220.0	73.3	91.2	86.9
Four Corners 4	111.0	75.9	90.6	90.9
Four Corners 5	111.0	90.6	83.0	62.8
Navajo 1	105.0	86.4	80.2	81.9
Navajo 2	105.0	81.4	91.4	79.1
Navajo 3	105.0	85.3	82.5	83.7
Cholla 1	110.0	82.4	68.7	85.9
Cholla 2	245.0	90.2	81.1	74.4
Cholla 3	260.0	76.0	86.5	81.1
W. Phx. CC 1	80.0	49.0	49.0	32.6
W. Phx. CC 2	80.0	40.0	60.2	33.7
W. Phx. CC 3	80.0	54.0	42.7	42.9
Ocotillo Steam 1	110.0	34.6	39.8	17.4
Ocotillo Steam 2	110.0	31.5	38.5	10.6
Saguaro Steam 1	110.0	27.2	36.7	9.3
Saguaro Steam 2	100.0	30.6	40.9	11.7
W. Phx CT 1	50.0	15.2	18.4	2.6
W. Phx CT 2	50.0	17.0	19.2	3.8
Ocotillo CT 1	50.0	11.2	24.4	3.3
Ocotillo CT 2	50.0	9.6	21.8	3.0
Saguaro CT 1	50.0	13.3	19.7	3.0
Saguaro CT 2	50.0	14.7	16.4	1.9
Yucca 1	18.0	5.0	23.4	3.7
Yucca 2	18.0	6.9	21.8	4.3
Yucca 3	52.0	12.2	22.0	14.1
Yucca 4	51.0	4.8	11.9	0.3
Douglas	15.0	3.2	14.5	0.2
Childs / Irving	4.2	66.8	65.9	59.7
<b>APS TOTAL</b>	<b>3927</b>			

NOTE: Capacity factors are affected by planned outages, forced outages, APS fuel and variable O&M costs, market prices of economy energy, operational constraints, and APS load requirements

**STAFF'S FIRST SET OF DATA REQUESTS TO ARIZONA PUBLIC SERVICE IN  
DOCKET NO's. E-00000A-02-0051, E-01345A-01-0822, E-00000A-01-0630  
AND E-01933A-02-0069 (TRACK B)  
October 15, 2002**

MR 1.4            Please list each contract under which APS obtains capacity and energy to serve its retail load. For each contract listed, please specify the contract's capacity and energy or load factor and the date it was entered into.

RESPONSE:

PacifiCorp Diversity Exchange

480 MW on-peak capacity limited to maximum 40% capacity factor May 15-Sep 15 each year. The contract was entered into September 1990.

Salt River Project Territorial Agreement

350 MW capacity for delivery January-December each year. This amount increases per a formula by 7 or 8 Mw per year. Energy is dispatchable and varies as a function of APS economics and to meet the needs of APS system reliability. The annual capacity factor has ranged from 31% to 59% in the 2000-2002 time frame. The contract was entered into in 1955 and was most recently amended in 1998.

Constellation Power (entered into March 2000)

25 MW on-peak capacity with 100% capacity factor during on-peak period for delivery July 2003 - September 2003

Williams Energy Marketing and Trading (entered into March 2000)

25 MW on-peak capacity with 100% capacity factor during on-peak period for delivery July 2003 - September 2003

Morgan Stanley Capital Group (entered into March 2000)

50 MW on-peak capacity with 100% capacity factor during on-peak period for delivery July 2003 - September 2003

Morgan Stanley Capital Group (entered into November 2001)

25 MW on-peak capacity with 100% capacity factor during on-peak period for delivery July 2003 - September 2003

NOTE: APS also has a QF agreement with Abitibi, but it is not for firm capacity or energy and thus has been excluded from APS resources for Track B purposes.

**STAFF'S FIRST SET OF DATA REQUESTS TO ARIZONA PUBLIC SERVICE IN  
DOCKET NO's. E-00000A-02-0051, E-01345A-01-0822, E-00000A-01-0630  
AND E-01933A-02-0069 (TRACK B)  
October 15, 2002**

MR 1.5            Please identify APS' forecasted unmet needs, i.e., the difference between forecasted load and capacity and associated unmet energy needs, for the years 2003, 2004, 2005, 2006, and 2007. Please identify the specific forecast used to determine your response, and please explain why that forecast was selected. For the purposes of this question, capacity and energy refers to rate-based generation assets and contracts to purchase power entered into before September 1, 2002.

RESPONSE:

See attached table [Attachment Staff DR 1, Q. MR 1.5] for the amount of energy and capacity APS currently expects to require to meet its reliability needs based on the October 2002 budget forecast. This is the most recent "official" forecast available. This table considers both its current rate-based generation assets referenced in Response MR 1.3 and the contracts referenced in Response MR 1.4. APS has further excluded capacity and energy for RMR above that provided from APS units because of the small number of even potential competitors and also amounts from renewable resources acquired or to be acquired under the EPS (APS believes this was a consensus position during the workshops).

In addition, APS expects to procure a certain amount of economy energy in each of these years depending solely on the actual energy cost of APS resources compared with market prices for power. Based on current expected forward market prices for natural gas and power, APS could potentially purchase up to 3,557 GWH of economy energy in 2003; 4,033 GWH in 2004; 6,695 GWH in 2005; 6,948 GWH in 2006, and 9,278 GWH in 2007. If actual power prices are 10% lower or higher (and all other factors remain as projected), APS would expect to make additional (fewer) economy energy purchases of 800 GWH or (500 GWH), respectively, for 2003 in response to these changing conditions.

This economy energy will be acquired competitively in a process that will permit qualified and interested sellers to participate and which APS will describe in more detail in its November 4, 2002 testimony in Track B.

As can be seen by the Attachment, APS requires approximately 22% of its 2003 retail load (plus reserves) to be competitively acquired in 2003, increasing to more than 25% in 2007. On the other hand, its energy needs are both significantly less initially and are at all times dependent upon the relative costs of gas and purchased power, but given current forecasts would range from some 15% in 2003 to 33% in 2007.

**Response to Staff Data Request MR 1.5**  
**APS Projected Unmet Capacity and Energy Needs as of 10/22/02**  
**2003 - 2007**

<u>Description</u>	2003		2004		2005		2006		2007	
	Capacity (MW)	Energy (GWH)	Capacity (MW)	Energy (GWH)	Capacity (MW)	Energy (GWH)	Capacity (MW)	Energy (GWH)	Capacity (MW)	Energy (GWH)
Total standard offer load <sup>1)</sup>	5,723	26,494	6,023	27,841	6,269	28,999	6,522	30,178	6,787	31,388
+ 15% reserve margin <sup>2)</sup>	598	-	602	-	602	-	606	-	606	-
- Physical capability of APS units <sup>3)</sup>	(3,927)	(24,132)	(3,953)	(25,313)	(3,949)	(25,733)	(3,975)	(26,563)	(3,975)	(28,047)
- Full capability of purchase contracts <sup>4)</sup>	(955)	(1,972)	(837)	(1,678)	(844)	(2,006)	(852)	(2,057)	(860)	(2,108)
- RMR generation from non-APS units <sup>5)</sup>	(29)	(0)	(184)	(2)	(338)	(8)	(493)	(27)	(647)	(40)
- Planned renewable energy supply under EPS <sup>6)</sup>	(9)	(41)	(17)	(85)	(23)	(114)	(29)	(142)	(35)	(170)
= Net unmet reliability needs <sup>7)</sup>	1,401	349	1,634	763	1,717	1,138	1,779	1,389	1,876	1,023

<sup>1)</sup> Standard offer load includes all retail customer energy and coincident peak demands plus APS wholesale contracts served by APS resources from Oct 2002 budget projections.

<sup>2)</sup> Under Staff's proposal, this calculation would be updated prior to any actual procurement.

<sup>3)</sup> Reserve margin is calculated on APS generation and known contingent purchases only.

<sup>4)</sup> Includes the production from all rate-based APS generation units subject to standard planned and forced outage assumptions.

<sup>5)</sup> Includes the contracts referenced in Response to Staff Data Request MR 1.4.

<sup>6)</sup> RMR generation assumes a Valley import limit of 3,535 MW, 660 MW of local APS generation, and 110 MW of required reserves. To the extent that bidders can demonstrate higher import capability or import capability is increased, RMR would be reduced, all else remaining the same. The present import limit of 3,535 MW assumes timely completion of the Southwest Valley line and also uses its most recent (and higher) capacity rating.

<sup>7)</sup> Includes solar and renewable resource additions planned each year under current funding levels. To the extent the Commission approves higher funding levels, capacity and energy under EPS will increase.

<sup>8)</sup> Energy figures do not include economy purchases, which as noted in the text of APS's response would add some 3,500 gwh in 2003 (and more in subsequent years) assuming present forecasts of gas and power costs.

<sup>1)</sup> Standard offer load includes all retail customer energy and coincident peak demands plus APS wholesale contracts served by APS resources from Oct 2002 budget projections. Under Staff's proposal, this calculation would be updated prior to any actual procurement.

<sup>2)</sup> Reserve margin is calculated on APS generation and known contingent purchases only.

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<sup>4)</sup> Includes the contracts referenced in Response to Staff Data Request MR 1.4.

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